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Summary:

San Diego Community Facilities District No. 2 (Santaluz), Improvement Area No. 1, California; Special Assessments

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Credit Profile

San Diego Comnty Facs Dist No. 2 (Santaluz) Imp Area No. 1 spl tax rfdg bnds

Long Term Rating

BBB+/Stable

Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'BBB+' rating, and stable outlook, on San Diego Community Facilities District No. 2 (Santaluz) Improvement Area 1 series 2011A special tax refunding bonds.

The rating reflects what we view as:

- An only adequate 16:1 direct and overlapping value-to-lien ratio after reductions in assessed value (AV) in the past few years;
- A large 17% of the levy from properties without improvement value and value to lien below 10:1; and
- Only adequate coverage of 1.1x annual debt service from special tax revenue, including from property without improvement value.

The preceding credit weaknesses are offset in part by what we consider:

- A diverse, primarily residential district located in San Diego;
- An improved tax collection rate in past couple of years; and
- A closed parity lien except for refunding purposes.

The bonds are secured by special taxes collected from real property within the district, net of administrative expenses.

San Diego Community Facilities District No. 2 is 20 miles northeast of downtown San Diego, and encompasses 2,546 gross acres. The district is primarily residential and levied a special tax on 997 parcels in fiscal 2013 with 83% of the special tax levy from completed parcels.

The district's direct and overlapping value-to-lien ratio as a whole is about 16:1 in fiscal 2013, reflecting what we consider to be a relatively large amount of district debt. The direct overall value to lien in fiscal 2013 is 22:1. In fiscal 2013, district AV remains relatively stable compared with fiscal 2012 at about \$1 billion. While the obligation to pay special taxes is unrelated to AV, AV does drive value-to-lien ratios on the properties.

In our view, given the primarily residential composition of the district, the tax base is diverse. The leading taxpayer, a golf course, comprises only 2.7% of the fiscal 2013 special tax levy.

Special tax rates vary across parcels based on square footage. The fiscal 2012 actual special tax ranged from \$1,588 for

a parcel under 1,750 square feet to \$8,040 for a residential custom lot; the corresponding assigned maximum rates range from \$2,140- \$10,830. An "undeveloped" property, as defined by the rate and method, is property owned by owners in the business of home building. The assigned maximum special tax for an undeveloped lot is very high, in our view, at \$22,969; there are 15 undeveloped parcels left in the district. While the district has not levied special taxes on undeveloped property as defined by the rate and method, the 2013 special tax levy is imposed on parcels that are vacant and undeveloped and that are owned by nonhome builders. Given the level of unimproved property, about 17% of the fiscal 2013 levy is generated by properties with a value to lien under 10:1, which we consider weak.

The district refunded about \$433,000 in taxes to property owners that had appealed the status of their parcels as custom lots as opposed to undeveloped property. The appeals revised the status of six custom lot parcels to undeveloped parcels under the rate and method definitions and for which the district has not levied a tax; officials report the refunds came from available district funds and not from the fiscal 2013 tax levy.

The median AV for improved single-family homes in the district is about \$1 million. For noncustom homes in the district and custom homes with improvement value, a sample total median overlapping effective tax rate represents about 1.5% of value. However, a sample effective tax rate for a custom lot without improvement value is much higher at almost 3% of value.

About 3% of the first installment of the tax levy was delinquent as of December 2012; however, substantially all of the previous year delinquencies had been collected. We understand the district has historically set the actual levy based on historical delinquency rates, estimated administrative fees, and debt service.

Officials report the district redeemed \$170,000 of bond principal from repayments in September 2012 and expects to redeem another \$200,000 in early March 2013, which slightly lowers annual debt service through maturity. The district's 2013 levy represents 66% of its maximum levy and maximum special taxes cannot escalate beyond fiscal 2013. The maximum tax levy would generate \$6.2 million, which would cover annual debt service in each year by about 1.5x. However, officials estimate a lower practical levy given state law that limits the levy increase to 10% on residential owners as a result of delinquencies. Assuming the district was to levy at 1.1x annual debt service, the district could withstand a 13% delinquency rate over the life of the bonds with the use of the debt service reserve.

Median household effective buying income for the City of San Diego is what we view as strong at 114% of the national levels. Unemployment for the city was 8.6% in October 2012, compared with 9.8% in October 2011. The city's unemployment rate is above the 7.9% national levels; however, it remains below the 10.1% state level.

Outlook

The stable outlook reflects our view of the district's diversity and strong median incomes, which we believe will likely provide support for continued good collections and coverage. Given the level of unimproved properties in the district, we are unlikely to raise the rating in the next two years. If development in the long-term causes AV in the district to increase such that debt ratios moderate, we could raise the rating. If delinquency rates were to return to the higher levels seen in previous years, we could lower the rating.

Related Criteria And Research

USPF Criteria: Special-Purpose Districts, June 14, 2007

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